Final Report of the Speaker's Advisory Committee on Tax Reform To the First Regular Session of the 121st Legislature

Members

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Executive Summary

For the past 20 years, the general public and the private sector have voiced concerns about the impact of state and local tax structures on Maine citizens and businesses. While the Maine economy has been undergoing substantial change from a natural resource based and manufacturing economy to a service based economy over the last 25 years, Maine's tax structure has not changed significantly since Governor Curtis reformed it 33 years ago.

The destabilizing effect of the current tax structure on state and local government revenues and the Maine economy has become well known. Economic upturns and downturns create a highly volatile and unpredictable revenue system that threatens state government's ability to meet even its basic commitments during difficult economic times. Revenue uncertainty also adversely affects the business community, which finds government commitments to business assistance and economic growth competing with other basic needs during economic downtimes.

In July 2002, the Speaker of the House, Michael V. Saxl, appointed a ten member **Advisory Commission on Tax Reform**, [hereinafter referred to as the Commission]. The members, whom the Speaker selected, have demonstrated effective leadership in Maine and possess expertise and broad experience in public policy and tax issues. Each member exemplifies objectivity in his or her professional work.

In addition, the Commission established a Technical Advisory Committee to provide information and develop proposals for consideration. The Technical Advisory Committee reviewed and commented on a number of tax reform proposals. In addition, the technical advisory group worked to resolve issues generated by various tax restructuring proposals in order to assist the Commission to reach consensus on a final tax-restructuring package.

The Advisory Committee held 9 meetings. All the meetings were open to the public. Experts in taxes, tax policies, business economics and economic development policies from within and outside the State made presentations to the Advisory Committee at its several meetings. In addition, members of the general public and representatives of different organizations made presentations or responded to issues raised at each session.

Through a comprehensive consensus-building process the Commission established a unanimous set of principles, findings and priorities for consideration and enactment by this legislature.

Principles:

1) Decrease volatility in revenues,
2) Embrace fairness by enhancing progressivity when possible,
3) Lower the tax burden with a deliberate long term plan to align Maine's broad-based taxes more closely to the national average and thereby make Maine a more attractive state in which to live, work, and start a business,
4) Achieve savings through regionalization and streamlining services where possible, and
5) Balance the mix of revenues between income, sales and property taxes.

Findings:

1.) Reforming the tax system does not simply mean eliminating state appropriations. Critical components of our economy and our quality of life demand consistent long-term funding, including:

- Quality education for K-12 students,
- A quality higher education system,
- Protection of Maine's most vulnerable population,
- Protection of the benefits currently enjoyed by Maine's businesses,
- Investment in research and development,
- Revenue stability

2.) Revenues can fluctuate significantly, depending upon the status of the economy. During economic downturns, revenues decline. During economic upturns, revenues increase. When economic recessions occur, the State has difficulty meeting its basic obligations.

3.) Maine's broad-based tax system is misaligned.

- Nationally, the property tax, the personal income tax, and the sales tax each account for roughly 25 percent of total state and local government revenues. Of total state and local revenues in Maine, the property tax represents 32 percent, the personal income tax represents 31 percent, and the sales tax represents 20 percent.

- If Maine were to realign its broad-based taxes to meet the national average, without any changes in state and local spending, the magnitude of the realignment would be $295 million. Of this amount, the property tax component alone, is $165 million.

4.) Maine's state and local tax system, overall, is regressive. The effective tax burden on lower income households is significantly more than the burden on middle and higher income households.

- K –12 Education Funding. Since the early 1990's, despite a $500 million or 43.8 percent increase in State funding of General Purpose Aid to Education, the State share of total education costs has shrunk to 43.6 percent. The State's commitment to fund 55 percent of total education costs has not been met, and the difference of roughly $240 million per year has fallen on the local property tax.

- Limited Local Tax Base and Exempt Property create a heavier burden on private homeowners. Targeting tax relief to these owners is the most efficient way to provide relief.

  - According to Maine Revenue Services Property Tax Division data, there is approximately $12.5 billion of property exempt from the property tax. 53.5% of all property tax exemptions are located in 18 municipalities. The total value of property that is exempt from the property tax in these 18 municipalities is $5,583,959,912. [This figure excludes Togus Veterans' Hospital that the Town of Chelsea controversially values at $2 billion]

5.) Maine's top personal income tax rate is eighth highest in the nation.

- There is concern and anecdotal information, but no systematic evidence at this time, that the top income tax rate discourages high-income people and businesses from locating in Maine and encourages the out-migration of this group from Maine.

- The Sales Tax, the second largest source of revenues to the General Fund, is projected to produce $868.2 million of revenues in FY 2003 or 36.4% of total General Fund revenues and 20% of total state and local revenues.

6.) The total value of sales tax exemptions and exclusions for FY 2003 is roughly $2.6 billion, which is more than the entire General Fund budget [$2.4 billion] for the same fiscal year.

Tax Reform must be fully funded. To act otherwise would be to undermine the stability and quality of essential state services including K-12 education, health services for our most vulnerable, and incentives for economic growth.

Recommendations

I. Residential Property Tax Relief

A. Reform of the Circuit Breaker Program. Creation of the Maine Home Tax Credit.

1. Reduce the tax-to-income threshold to 3.0 percent,
2. Increase the maximum rebate to $5,000,
3. Increase income eligibility to $45,000 for single filers,
4. Increase income eligibility to $75,000 for married filing jointly,
5. Increase the renter percentage to 25 percent,
6. Provide for a refundable tax credit on the income tax form.

B. Index income and rebate to the consumer price index

C. Cost to the General Fund: $48,000,000

The Committee suggests that the 3.0% threshold be reduced to 2.5% over a 4-year period. The additional cost of the reduction in the Circuit Breaker to 2.5% is $27,000,000.

II. Personal Property Tax Relief

Property Tax Relief for Business Equipment

A. Phase in a property tax exemption for business equipment and phase out the BETR program as follows:

1. Establish an exemption from property tax prospectively for businesses that qualify for BETR and that applies to business equipment of the type that qualifies for BETR, including without limitation manufacturing firms, but with the following exceptions:

   - Also exempt business equipment of telecommunications firms (which does not now qualify for BETR);

   - Exclude from the exemption business equipment used at storefront retail locations where retail purchases of goods are made. The exemption, however, shall apply to computers even if used at storefront retail locations, except that computer systems at retail locations used for inventory control and cash registers will be taxable. The exemption will also apply to equipment at warehouse facilities, including those that support retail stores (*i.e.*, L. L. Bean and Wal-Mart distribution facilities). Those warehouse facilities **will not** be considered part of retail sales facilities.

2. The exemption shall apply to qualifying property placed in service after April 1, 2003 and qualifying BETR property as it exits the BETR program.

3. Property placed in service prior to April 1, 1995 will remain taxable.

4. Property that is currently in the BETR program will continue in the BETR program and remain taxable so long as it is in the BETR program.

B. At the option of the municipality, the State may assume responsibility for assessing personal property valued at $10 million or more, and the State may charge a fee for this service.

C. As required by the Maine Constitution, the State will reimburse municipalities for 50 percent of the losses from changes in the property tax on business equipment.

D. First Year Cost to the General Fund: No net loss. Savings from the dismantlement of the Business Equipment Tax Refund program will offset the costs of the exclusions in the early years.

E. Long-term Cost to the General Fund: Could be as high as or higher than $50 million in 10 to 15 years.

F. With the exception of retail stores, exclude from the Business Equipment Tax, new investment made by firms currently eligible for the BETR program in business equipment that currently qualifies for BETR, including but not limited to manufacturing firms.

III. Revenue Sharing

A. Keep Revenue Sharing 1 in its present form, including application of the Consumer Price index to funding increases in this program.

B. Increase from 5.1 percent to 6.0 percent, the percentage of sales and income tax revenues allocated to Revenue Sharing. Apply the increased revenues to Revenue Sharing 2.

C. Increase the threshold mil rate from 10 to 15 mils over a 5-year period that a municipality must meet to qualify for Revenue Sharing 2.

D. First Year Cost to the General Fund: $16,999,021

IV. Individual Income Tax

A. Increase the personal exemption to the same amount as the Federal exemption.

1. Cost to the General Fund: $10,159,716

B. Increase the refundability of the Earned Income Tax Credit, initially to 15 percent of the Federal Rate. The rate of refundability will increase by 5 percent each year until it reaches 30 percent of the federal rate.

1. Cost to the General Fund – at the 30% rate: $34,991,628
2. Cost to the General Fund – at the 15% rate: $16,000,000

C. Reduce the top income rate of 8.5 percent to 8.0 percent, effective January 2004

1.) Cost to the General Fund in FY 2005: $45,000,000
2.) Cost to the General Fund in FY 2006: $60,000,000

V. Budget Stabilization Fund

Over the long-run, the Budget Stabilization Fund will protect taxpayers and shield current services. When revenues fluctuate during economic downturns, this fund will become available to offset tax increases or deep program cuts.

A. Beginning in FY 2006, the Budget Stabilization Fund will replace the current Rainy Day Fund. The Budget Stabilization Fund will be funded “off the top” from the General Fund at a rate of 2% of total revenues. The Budget Stabilization Fund will be capped at 12% of General Fund revenues.

B. Consistent with current law, 25 percent of revenues in excess of projected revenues will be appropriated to the Budget Stabilization Fund.

C. Total Estimated Cost to the General Fund in FY 2006: 56,000,000

VI. Commission on the Efficient Delivery of Services [Regionalization/Consolidation]

A. The Commission on the Efficient Delivery of Services, appointed by the Governor and presiding officers of the Legislature, is established to develop a plan for Legislative approval for the efficient delivery of local, regional, and state governmental services to include, but not be limited to the regionalization of administration and implementation of services.

B. The Commission will consist of representatives of municipal, county, and state governments, as well as representatives of the private sector, the General Public, and the Maine Municipal Association.

C. The Commission will report its findings and recommendations to the Second Regular Session of the 121st Legislature.

VII. Commission on the Efficient Delivery of K – 12 Education Services

A. A commission, appointed by the Governor and Presiding Officers of the Legislature, is established to study and recommend to the Legislature an implementation plan for the efficient delivery of K – 12 educational services. This commission will, at a minimum:

1. Review the current educational delivery system, to include strengths and weaknesses,
2. Analyze alternatives to the current delivery system that maximize outcomes at least cost,
3. Consider regionalization of educational administration and services,
4. Review alternatives for the purchasing of supplies and equipment to maximize savings,
5. Review the assets of the current educational system and the best uses of these assets.

B. The Commission will be composed of representatives of the education community, including superintendents, principals, teachers, municipal officials, state education and financial officials, the Maine Education Association, the Maine School Management Association, the General Public, and Maine Municipal Association.

C. The Commission will report its findings and recommendations to the First Regular Session of the 122nd Legislature.

VIII. Tax Exempt Entity Payments for Municipal Services.

A. Authorize municipalities to establish and assess a municipal cost component or protective services assessment for services provided to owners of tax-exempt entities, including governmental entities.

B. A Commission, appointed by the Governor and Presiding Officers of the Legislature, and representing local, state, and county governments, the Maine Municipal Association, Not for Profit entities, and the General Public is established to develop a formula or process for municipalities to use to determine the municipal cost of service component for tax- exempt entities.

C. In determining the municipal cost component or protective services assessment, the Commission must take into consideration the characteristics of different properties including, vacant property, property with facilities, square footage of facilities, equipment, and

D. Any other characteristics that impact the cost of providing municipal services.

IX. Cost of Advisory Committee Recommendations

FY 2004 -	$ 91,158,737
FY 2005 -	$136,158,737
Total 2004-05 Biennial Revenues	**$227,317,474**

FY 2006 - $252,158,737 – Includes the loss of revenues from the funding of the Budget Stabilization Fund, which takes effect in FY 2006.

Sources of Revenues to Fund Committee Recommendations

A. The following Sales Tax exemptions may be eliminated:

1. Publications sold on short intervals,
2. Sales to private schools and colleges,
3. Sales to regularly organized churches,
4. Sales to institutions conducting medical research or scientific study in biology,
5. Camp rentals,
6. Funeral services,
7. Sales through coin operated vending machines,
8. Sales to day-care centers and nursery schools,
9. Sales to community action agencies, child abuse councils, & child advocacy organizations,
10. Sales by schools and school-sponsored organizations,
11. Sales to monasteries and convents,
12. Sales to state chartered credit unions,
13. Meals and lodging provided to employees,
14. Certain aircraft parts,
15. Personal services,
16. Amusements and recreational services,
17. Consumer purchases of memberships in social and miscellaneous services (Charitable donations and labor union dues remain exempt)
18. Consumer purchases of transportation services, except publicly owned transportation services,
19. Consumer interstate calls

- Total Revenue from the elimination of selected Sales Tax exemptions in FY 2004: $76,200,000

B. Increase the tax on wine by 15 cents per bottle and the tax on beer by 25 cents per six-pack

- Total Revenues realized in FY 2004: $21,000,000

C. Increase the Meals and Lodging Tax from 7 percent to 8 percent, and an increase in the Lodging tax to 10 percent.

- Total Revenues from increases in the Meals and lodging taxes: $27,000,000+

Total Revenues in FT 2004	**$124,200,000**:
Total Revenues in FT 2005	**$124,200,000**:
Total Revenues – 2004-05 Biennium	**$248,400,000**

Out-Year Considerations

The Advisory Committee was unanimous in all its findings and recommendations for the immediate future. With respect to longer-term proposals, the Commission suggests that the Legislature give serious consideration to the following (no priorities are established for each item):

A. Increased property tax relief through the Circuit Breaker
B. Expansion of the income brackets to which income tax rates are applied
C. Increased refundability of the Earned Income Tax Credit
D. Reduction in the top rate of the personal income tax
E. Increased aid to education

Conclusion

Tax reform is critical to Maine's future. Through it we can provide predictability in state revenues, fairness in ability to pay and future economic growth. This package is fully funded and will immediately realign the tax burden and improve the progressivity of our current system.

Long-term efforts to reduce the tax burden must be connected to economic growth and must be balanced against important state investments, including: K-12 funding, higher education, research and development and incentives for economic growth. A strong economy demands a balance of revenues for critical services with an environment, which is friendly towards growth.

A number of reform efforts will come forward this year. We ask that they be evaluated by a strict standard of principles including: fairness, sustainability, and explicit funding sources.

Many individuals participated in this effort and many different ideas were put forward. Following this executive summary is a complete discussion of the issues considered, suggested source readings, agendas, and a list of participants.

Final Report of the
Speaker's Advisory Committee on Tax Reform

March 10, 2003

Introduction

For the past 20 years, the general public and the private sector have voiced concerns about the impact of state and local tax structures on Maine citizens and businesses. While the Maine economy has been undergoing substantial change from a natural resource based and manufacturing economy to a service based economy over the last 25 years, Maine's tax structure has not changed significantly since Governor Curtis reformed it 33 years ago.

The destabilizing effect of the current tax structure on state and local government revenues and the Maine economy has become well known. Economic upturns and downturns create a highly volatile and unpredictable revenue system that threatens state government's ability to meet even its basic commitments during difficult economic times. Revenue uncertainty also adversely affects the business community, which finds government commitments to business assistance and economic growth competing with other basic needs during economic downtimes.

In July 2002, the Speaker of the House, Michael V. Saxl, appointed a ten member Advisory Committee on Tax Reform, hereinafter referred to as the Advisory Committee. The members, whom the Speaker selected, have demonstrated effective leadership in Maine and possess expertise and broad experience in public policy and tax issues. Each member exemplifies objectivity in his or her professional work.

As the result of an increasingly onerous state and local tax burden on Maine people, the Advisory Committee was created to achieve three purposes: 1) to decrease volatility in revenues, 2) to enhance and move the Maine tax system toward greater progressivity and 3) to lower the tax burden. The property tax, in particular, has grown at an alarming rate, and several citizens' initiatives to address this issue have been circulated in the last decade. Currently, three citizens' property tax initiatives are in circulation for resident signatures.

In addition to addressing the property tax burden on Maine people, the Advisory Committee investigated the extent to which adjustments to other broad-based taxes are necessary. The intent of the Advisory Committee is to align Maine's broad-based taxes more closely to the national average and thereby make Maine a more attractive state in which to live, work, and start a business.

In a parallel action, the Speaker created the "Technical Advisory Committee" to the Advisory Committee on Tax Reform. The Technical Advisory Committee consists of approximately 12 active members representing several major interest groups, including, but not limited to, the Maine Municipal Association, the Maine Education Association, the Maine State Chamber of Commerce and Industry, the Maine Center for Economic Policy, the Maine Equal Justice Project, the Maine Women's Lobby, the State Economist and Maine Revenue Services.

The Technical Advisory Committee provided technical information and developed proposals for consideration by the Speaker's Advisory Committee on Tax Reform. This advisory group worked to resolve issues generated by various tax restructuring proposals in order to assist the Advisory Committee to obtain consensus on a final tax-restructuring package.

The Technical Advisory Committee both responded to and made presentations to the Speaker's Advisory Committee on Tax Reform with regard to current tax policies and their impact on Maine. In addition, it reviewed and commented on a number of tax reform proposals.

Prior to formulating a tax reform package, the Advisory Committee conducted an extensive review of the literature on taxes and tax policies, especially the goals and guiding principles governing these policies. Based on considerable discussion and analysis, the Advisory Committee adopted the following:

A. Goal #1

A reformed tax system should sustain what the people want, including:

1. Quality education for K-12 students,
2. A quality higher education system,
3. Protection of Maine's most vulnerable population
4. Protection of the benefits currently enjoyed by Maine's businesses,
5. Revenue stability

B. Goal #2

- A reformed tax system should meet the standards of equity, fairness, and progressivity.

C. Goal #3

- A reformed tax structure should lower the tax burden (taxes as a percent of Maine residents' income) over the long run.

D. **Guiding Principles of Tax Reform**. A tax system should reflect:

1. Decrease volatility in revenues,
2. Embrace fairness by enhancing progressivity when possible,
3. Lower the tax burden with a deliberate long term plan to align Maine's broad-based taxes more closely to the national average and thereby make Maine a more attractive state in which to live, work, and start a business,
4. Achieve savings through rationalization and streamlining services where possible, and
5. Balance the mix of revenues between income, sales and property taxes.

The Advisory Committee held 9 meetings. All the meetings were open to the public. Experts in taxes, tax policies, business economics and economic development policies from within and outside the State made presentations to the Advisory Committee at its several meetings. In addition, members of the general public and representatives of different organizations made presentations or responded to issues raised at each session.

Findings

I. The Tax/Revenue System

A. Maine's State tax and revenue system is highly volatile and unreliable.

- Revenues can fluctuate significantly, depending upon the status of the economy. During economic downturns, revenues decline. During economic upturns, revenues increase. When economic recessions occur, the State has difficulty meeting its basic obligations.

B. Part of the revenue-fluctuation problem is the result of a narrow tax base system.

- Motor vehicle and construction material sales produce over 25 percent of total sales tax revenues. These items are highly susceptible to economic trends and resident discretionary spending.

- Capital gains are an important factor with respect to personal income tax revenues. Capital gains are also highly susceptible to business cycles and market conditions. In tax year 2001, Maine Revenue Services estimates that capital gains revenues fell 60 percent and account for at least two-thirds (2/3) of the drop in personal income tax revenues.

C. Maine's broad-based tax system is misaligned.

- Nationally, the property tax, the personal income tax, and the sales tax each account for roughly 25 percent of total state and local government revenues. Of total state and local revenues in Maine, the property tax represents 32 percent, the personal income tax represents 31 percent, and the sales tax represents 20 percent.

- If Maine were to realign its broad-based taxes to meet the national average, without any changes in state and local spending, the cost to realign the broad-based tax system would be $295 million. Of this amount, the property tax cost, alone, is $165 million.

D. **Maine's state and local tax system, overall, is regressive.** The effective tax burden on lower income households is more than twice the burden on middle and higher income households.

E. **K –12 Education Funding.** Since the early 1990's, despite a $500 million or 43.8 percent increase in State funding of General Purpose Aid to Education, the State share of total education costs has shrunk to 43.6 percent. A statutory provision committing the State to 55 percent of total education costs has not been met, and the difference of roughly $240 million per year has fallen on the local property tax.

- It should be noted that the State's funding share or 43.6 percent of total education costs does **not** include the cost of teacher retirement that is paid wholly by the State. The cost to the State for teacher retirement is $332 million for the 2002-03 biennium.

Distribution of the Current State and Local Tax Burden
Calendar Year 2000

Income Range	% of Total Households	% of Total Household Income	Total Taxes Paid	% Of Total State & Local Taxes Paid	% Of Income Paid as State & Local Taxes
$0 $11,999	20.0%	2.4%	$155,500,000	5.4%	23.5%
$12,000 - $19,134	10.0%	3.0%	$123,100,000	4.3%	15.26%
$19,135 - $27,019	10.0%	4.5%	$145,800,000	5.0%	11.96%
$27,020 - $35,649	10.0%	6.0%	$181,000,000	6.3%	11.07%
$35,650 - $45,124	10.0%	7.8%	$216,800,000	7.5%	10.17%
$45,125 - $55,374	10.0%	9.6%	$261,600,000	9.0%	9.95%
$55,375 - $70,299	10.0%	12.1%	$318,600,000	11.0%	9.66%
$70,300 - $96,349	10.0%	15.7%	$404,500,000	14.0%	9.43%
$96,350 & Over	10.0%	38.9%	$1,089,000,000	37.6%	10.28%
Total	100.0%	100.0%	$2,896,000,000	100.0%	10.62%

1. As household income increases, the effective tax burden decreases, with the exception of one slight increase in tax burden for the highest income bracket.

II. The Property Tax

1. According to Maine citizens, of all the broad-based taxes, the property tax is considered the most onerous tax. The property tax is the only tax in the last decade that Maine residents, by citizens' petitions, have sought to reduce and limit.

2. The burden of the property tax is amplified, in part, by the payment process. Unlike the personal income tax and sales tax, which are paid in installments over a twelve-month period, property tax payments are made twice a year and, therefore, seem to take a bigger bite out of the wallet.

3. The cost of K – 12 education, which comprises the largest portion of municipal expenses, has been increasing at a greater rate than all other municipal government programs and greater than the rate of inflation. As a result, property taxes, which fund most municipal programs, have been increasing significantly, compared to other taxes.

4. In a number of Maine municipalities there has been substantial increases in property values and corresponding increases in property taxes, especially in coastal communities.

III. Income Taxes

A. The personal or individual income tax is projected to produce nearly $1.1 billion or 44.9% of total General Fund revenues and 31% of total state and local revenues.

B. The Maine personal income tax is the only tax in the State with progressive tax rates. Despite the rate structure, the burden on lower income households is significantly more than the burden on middle and upper income households.

C. The Maine personal income tax is steeply progressive, and the highest rates apply to middle income households.

Current Personal Income Tax Brackets and Rates

Single Filers: Up to $4,199 = 2.0%; $4,200 to $8,349 = 4.5%; $8,350 to $16,700 = 7.0%; and more than $16,700 = 8.5%
Married Filing Jointly: Up to $8,399 = 2.0%; $8,400 to $16,699 = 4.5%; $16,700 to $33,400 = 7.0%; More than $33,400 = 8.5%.
Heads of Households: Income tax brackets are 1.5 times the brackets for single filers.

D. Maine's top personal income tax rate is one of the highest in the nation.

1. There is concern and anecdotal information, but no systematic evidence at this time, that the top income tax rate discourages high-income people and businesses from locating in Maine and encourages the out-migration of this group from Maine.

E. The corporate income tax is projected to produce $93.1 million or 3.9% of total General Fund revenues in FY 2003.

1. The corporate income tax ranks 5th with respect to the proportion of revenues produced for the General Fund.

F. The corporate income tax in Maine is in line with the corporate income taxes of other states.

IV. The Sales Tax

A. The Sales Tax, the second largest source of revenues to the General Fund, is projected to produce $868.2 million of revenues in FY 2003 or 36.4% of total General Fund revenues and 20% of total state and local revenues.

B. The Sales Tax base is limited or reduced by the number and amount of sales tax exemptions and exclusions, which significantly reduce revenues from this tax source.

- The shrinking of the sales tax base, relative to total expenditures, has resulted, in part, from the steady long-term shift to a service economy, and untaxed sales of services account for an ever-larger reduction in sales tax revenues.

C. The total value of sales tax exemptions and exclusions for FY 2003 is roughly $2.6 billion, which is more than the entire General Fund budget [$2.4 billion] for the same fiscal year.

D. While many sales tax exemptions and exclusions have been enacted to reduce the cost of goods and services considered to be essential to Maine citizens, such as health care, food, home energy needs, prescription drugs, and educational tuition, there are many exemptions and exclusions for "luxury" goods and services and for specific industries in Maine.

V. Consolidation/Regionalization – Reducing the Cost of Government

A. Rising property taxes are due, in part, to increasing costs of government and increased costs of K – 12 education, both of which are rising faster than the rate of inflation. According to a report of the State Planning Office, regionalization or consolidation of state, county, and local government services could save roughly $55 million per year when fully implemented.

- Education costs, in particular, comprise the most substantial portion of local government expenditures. Currently, the cost of education is driven by local school districts, and there is concern that there is inadequate control over this cost.

B. According to a recent University of Maine research publication, " there is too much duplication of public educational services…. It appears that some of our school districts and schools are too small."

- The comparatively large number of separate school districts (261) per number of students, and the comparatively small number of students per school and school district increases educational costs considerably in Maine
- The cost per student in school administrative districts with 3500 or more students ranged from $5,000 per student to $7,000 per student compared to the cost range of $5,000 to $12,500 per student for school units with less than 1000 students.

- Based on 2001 data, Maine's average student population of 754 students per school administrative unit is 23.5 percent of the national average of 3210 students per school administrative unit.

- Based on 2001 data, Maine's average student population of 304 students per school is 55.7 percent of the national average of 546 students per school.

- There is statistically valid evidence, primarily 4th and 11th grade test scores, that students in schools with larger student populations perform better than students in schools with smaller student populations. The correlation factor is statistically insignificant, however, with respect to eighth grade student test scores and the size of the student population.

VI. Limited Local Tax Base and Exempt Property

A. For some municipalities with significant numbers of properties that are exempt from the property tax, local and county government costs borne by the remaining property taxpayers are onerous. While protective services, such as fire, ambulance, and police protection provided by municipalities may be costly, these costs become more burdensome in municipalities with a comparatively larger number of properties that are exempt from the property tax. In only a very few cases do the exempt property owners make municipal services payments in lieu of taxes.

1. According to Maine Revenue Services Property Tax Division data, there is approximately $12.5 billion of property exempt from the property tax. This figure is inflated by the $2 billion property value that the town of Chelsea attributes to Togus Veteran's Hospital. If the Chelsea valuation of exempt property is excluded, the total value of exempted property tax in Maine in 2001 is $10,437,953,316.

2. Maine Revenue Services Data shows that **53.5% of all property tax exemptions are located in 18 municipalities, each of which record total municipal property valuation in excess of $100 million that is exempt from the local property tax. These 18 municipalities represent 3.7% of all Maine municipalities. The total value of property that is exempt from the property tax in these 18 municipalities is $5,583,959,912**.

3. The Data also shows **that 40% of all property valuation excluded from the property tax is located in 9 municipalities, each of which record total municipal property valuation in excess of $200 million.** The total value of property that is exempt from the property tax in these 9 municipalities is $4,220,127,822.

4. The remaining 96.3% of the municipalities or 471 municipalities each have an average of $10.4 million of property that is exempt from the property tax.

5. Excluding the valuation of Togus Hospital from total value of property exempt from the property tax, of all tax-exempt property value:

- $2,917,253,194 or 27.9% is owned by public municipal corporations,
- $1,350,532,787 or 13.0% is owned by the United States government,
- $1,165,701,022 or 11.2% is owned by benevolent and charitable institutions.
- $1,101,467,682 or 10.6% is owned by literary and scientific institutions,
- $ 916,526,038 or 8.8% is owned by the State of Maine,
- $ 778,926,098 or 7.5% is owned by quasi-municipal organizations,
- $ 627,309,394 or 6.0% is owned by churches,
- $ 302,921,874 or 2.9% is owned by pollution control facilities,
- $ 259,668,373 or 2.5% consists of airports or land fields,
- $ 253,187,595 or 2.4% is property leased by hospitals,
- $ 221,320,286 or 2.1% is owned by public water facilities,
- $ 112,482,114 or 1.1% is owned by fraternal/veterans' organizations,
- $ 105,995,615 or 1.0% consists of pipes, fixtures, and hydrants,
- $ 65,510,525 or 0.6% is sewerage facility property, and
- $ 250,510,880 or 2.4% is owned by several other entities, such as the Chamber of Commerce , water resources boards, etc.

Recommendations

The Speaker's Advisory Committee on Tax Reform fully funds the tax reform package proposed in this report. Unlike other tax proposals, including initiated bills and referenda that propose major tax reforms or significantly impact government revenues without specifying the means to fund these reforms and proposals, the Advisory Committee has developed a funding package to support its recommendations.

I. Property Tax Relief - Residential

A. Property tax relief should be targeted to lower and middle-income residents whose property tax burden creates financial hardships for them or the assessment is an extraordinary proportion of their income. Residents and nonresidents who can afford the tax assessed against their property should not be afforded relief.

B. Proposal

1. Eligibility.

   - Single filers with an income of $45,000 or less.
   - Married Filing Jointly with an income of $75,000 or less
   - The property tax threshold for eligibility is reduced from 4 percent of income to 2.5 percent of income.

2. Reimbursement.

   - The reimbursement cap is increased from $1,000 to $5000.

3. Rent component.

   - The percentage of monthly rent considered to be property tax is increased from 18 percent to 25 percent..

4. The income thresholds are indexed for inflation.

5. Cost to the General Fund $48,000,000

The Advisory Committee suggests that the 3% threshold be reduced to 2.5% over a 4-year period. The additional cost of the reduction in the Circuit Breaker is $27,000,000 per year.

II. Property Tax Relief – Business

A. Background

1. One of the most burdensome taxes on business enterprise, according to business spokespersons, is the personal property tax. The Personal Property Tax assessed on business is also known as the Business Equipment Tax. This tax, it is argued, discourages businesses from locating and expanding in Maine. Like all property taxes, this tax is not related to the profitability or revenues of a business.

2. While most states assess a personal property tax on business machinery and equipment, the rate and exemptions widely vary from state to state. The Business Equipment Tax in Maine is considered to be one of the highest in New England.

In many Northeastern and New England states, there is either no personal property tax assessed on business machinery and equipment or the tax is minimal.

3. The current Business Equipment Tax Reimbursement Program in Maine relieves many businesses of this burden, but the funding of this program is placed in jeopardy each year as the Governor and the Legislature develop and amend the General Fund Budget. The uncertainty of the life of this program creates anxiety throughout the business community, which impacts business investment and the adoption of new technologies.

4. One intent of the Business Equipment Tax Reimbursement program is to encourage the growth and development of businesses that pay good wages and benefits, are environmentally compatible, and reinvest in modern technology as a means of ensuring their future. It is also intended to keep good businesses in Maine that could be enticed to locate in other states. The program is not intended to provide relief to businesses that pay minimum wages and/or would locate in Maine without any Maine incentives.

B. Proposal

1. The personal property tax levied on business, also known as the Business Equipment Tax, is eliminated, prospectively, for many businesses, particularly manufacturing and telecommunications firms, as well as for highly technological equipment and for new investment made by firms currently eligible for the BETR program.

2. Personal property of storefront retail establishments, under the proposal is not eligible for elimination from the tax, except personal property or business equipment in warehouse facilities that support retail establishments will not be taxed. Computerized systems, other than systems for inventory control and cash registers, under this proposal is eligible for the tax exemption.

3. All current property in the BETR program will continue in the program, remain taxable, and remain subject to reimbursement. Following its exit from the BETR program, personal property eligible for an exemption from the personal property tax under this proposal will remain exempt from the personal property tax.

4. The Business Equipment Tax Reimbursement Program will be eliminated once all current personal property has been removed from the program.

5. Business equipment and personal property placed in service prior to April 1, 1995 will remain taxable.

6. Eligible property placed in service after April 1, 2003 will be exempt from the Business Equipment Tax.

III. Additional Aid for Municipalities

Service center communities are experiencing significant property tax pressures. Residents in rural and suburban communities extensively use the facilities and services of the service center communities, but do not adequately compensate the service centers for the use of their services and facilities.

A. Proposal

1. Keep Revenue Sharing 1 in its current form, including the application of the Consumer Price Index to funding increases in the program.

2. Expand funding to Revenue Sharing 2 by increasing from 5.2% to 6% the amount of sales and income tax revenues allocated to Revenue Sharing. The entire increase in funding will be allocated to Revenue Sharing 2.

3. Municipal eligibility for Revenue Sharing 2 will be increased from a tax rate of 10 mils to 15 mils over a 5-year period.

4. First-year cost to the General Fund $16,999,021

IV. Maine Resident Homestead Property Tax Exemption

A. The Maine Resident Homestead Property Tax Exemption provides a $7,000 exemption from the just value of the primary residence of each permanent Maine resident. Businesses and non-residents are not eligible for the tax exemption. Every permanent Maine resident receives this exemption, regardless of income and means.

B. The Maine Resident Homestead Property Tax Exemption costs $40.2 million each year. The Advisory Committee recommends keeping the Homestead Tax Exemption because many residents have come to depend upon it, and the loss of this exemption would increase property taxes.

V. Municipal Services – Exempt Property

A. Background

1. Tax-exempt property poses hardships for many municipalities. In 2001, total exempted property for all municipalities in Maine amounted to $12,446,202,616. Of this amount, $2,004,034,500 is attributed to Togus Hospital and may not be a reliable figure, which if deducted, leaves $10,437,953,316 of Tax-exempt property. Of this amount, 64 percent was concentrated in four counties – Cumberland, Kennebec, Penobscot, and York Counties.

2. For municipalities with comparatively larger amounts of tax-exempt property, their ability to meet the basic needs of residents in these towns and cities is made very difficult. The loss of revenues from these untaxed properties also increases the tax burden on the remaining taxpayers.

3. Service center municipalities often have considerable amounts of tax-exempt property that require municipal services.

B. Proposal. To address this problem, the Advisory Committee proposed:

1. To authorize municipalities to establish a municipal cost component or protective services assessment for services provided to exempt entities and to assess a municipal cost of service fee against these entities, including governmental entities.

2. The creation of a Commission On the Assessment of Protective service Payments on Tax-exempt Property. The Commission will consist of 13 members, of whom 5 will be selected by the Speaker of the House, 5 will be selected by the President of the Senate, and 3 will be selected by the Governor. The Commission would be comprised of municipal, state, and county officials, a representative of a Not-for-Profit organization, a representative from the Maine Municipal Association, and a representative of the General Public.

3. The Commission will develop a formula or municipal service fee to be levied against tax-exempt property owners. In determining the fee or fees to be assessed against each owner of tax exempt property, the Commission will take into consideration the characteristics of each tax exempt property such as number and square footage of buildings, if any, equipment, other facilities, and services provided to each tax exempt property.

4. The Commission will report its findings and recommendations to the Second Regular Session of the 121st Legislature.

VI. Income Tax Relief

A. Background

1. Maine ‘s highest personal income tax rate of 8.5% is among the highest rates in the nation. The top 20% of households with respect to income [$70,300 and over] earned 54.6% of total income in Maine and paid 51.6 percent of total taxes on resident individuals in calendar year 2000.

2. Maine’s highest income tax rate also applies to middle-income households with annual incomes from $35,650 to $70,299. Comprising 30% of total households and earning 29.5% of total income in Maine, taxpayers in this category pay 27.5% of total taxes on resident individuals.

3. Therefore, 50% of Maine households pay the highest tax rate in Maine for all or some fraction of their income.

B. Short-term or Immediate Proposal

1. Reduce the highest personal income tax rate from 8.5% to 8.0% beginning in January 2004.

2. Gradually increase the Earned Income Tax Credit to 30% of the federal rate. In the first year, the tax credit will begin at 15% and increase by 5% each year until it reaches 30%. In addition, the Earned Income Tax Credit will become a refundable tax credit on the personal income tax form.

3. Increase the personal exemption to conform to the federal exemption, including the phase-out for high-income taxpayers.

C. Out-year Considerations

The Advisory Committee was unanimous in all its findings and recommendations for the immediate future. With respect to longer-term proposals, the Commission suggests that the Legislature give serious consideration to the following (no priorities are established for each item):

1. Increased property tax relief through the Circuit Breaker
2. Expansion of the income brackets to which income tax rates are applied
3. Increased refundability of the Earned Income Tax Credit
4. Reduction in the top rate of the personal income tax
5. Increased aid to education

VII. Budget Stabilization

A. Background

1. Unlike municipal governments, which have a reliable revenue source based on property valuation that generally appreciates over time, State government is faced with highly volatile revenues as economic conditions change. Relying on tax revenues that are very sensitive to ups and downs in the business cycle, state government finances are highly vulnerable in business cycles. During periods of economic downturns when revenues drop, it is sometimes difficult for State government to meet its basic commitments without tax or fee increases.

2. A budget stabilization fund can help offset the problem posed by revenue volatility.

3. Many states have budget stabilization funds. Maine has the Rainy Day Fund, but it is too limited in scope to address a major downturn in revenues. The Maine Rainy Day Fund is capped at 6% of General Fund Revenues.

B. Proposal

1. Establish a Budget Stabilization Fund to be funded by a 2% assessment against total General Fund revenues. The Budget Stabilization Fund will be capped at 12% of total General Fund Revenues. The same provision governing the allocation of surplus revenues to the Rainy Day Fund will apply to the Budget Stabilization Fund. A maximum of 25% of “surplus” revenues will be deposited in the Budget Stabilization Fund.

2. The Legislature will establish criteria for the use or expenditure of these funds.

VIII. Economic Development Strategy

A. Whenever revenues exceed projections, the "excess" revenues should be expended in a manner that enhances Maine's economic growth and development. Maine needs more jobs, especially good paying jobs, not only to increase per-capita income, but also to retain young adults in the workforce. Currently there is an out migration of young Maine citizens under 34 years of age who are migrating to other states and beyond.

B. To turn the economy around,

1. One-third of excess revenues should be used to fund K – 12 education through the "Essential Programs and Services" account in the General Fund budget,

2. One third of the "excess" revenues should be used to reduce taxes, and

3. The remainder of "excess" revenues should be used to promote sustainable development through investment in research and development and higher education.

IX. Commission on the Efficient Delivery of Governmental Services

According to the State Planning Office, there is duplication of effort and services provided by municipalities. There is a potential savings of $55 million per year if some municipal services are consolidated or regionalized. The most significant cost component in municipal budgets is education, which can comprise as much as 70 or 80% of a municipality's budget.

A. Proposal

1. The Commission on the Efficient Delivery of Governmental Services is created to review, analyze, and recommend a system for the consolidation and regionalization of governmental services. The Commission must include, at a minimum, a plan for the regionalization of administration of different programs and services and the consolidation of the delivery of services. The Plan must include one or more pilot projects as a means to determine the most effective approaches to consolidation and regionalization.

2. The Commission will be composed of 13 members chosen as follows:

- Five (5) members will be selected by the President of the Senate,
- Five (5) members will be selected by the Speaker of the House, and
- Three (3) members will be selected by the Governor.

3. The Commission shall be comprised of

    - Local, county, and state officials,
    - A representative of the Maine Municipal Association
    - A representative of the private sector, and
    - A representative of the general public.

4. The Commission will report its findings and recommendations, including any necessary implementing language to the Second Regular Session of the 121st Legislature.

X. **Education services**.

A. The consolidation/regionalization of education services shall be reviewed and analyzed for the purpose of reducing the cost of education. This study may be done independently or in conjunction with the study to review and analyze the potential for the consolidation and regionalization of municipal services. If the study on the consolidation of municipal services and the study on the consolidation of educational services and programs are conducted by the Commission On the Efficient Delivery of Services, additional members representing the Education community must be appointed to the Commission.

B. If the study on the consolidation and regionalization of educational services and programs is conducted independently of the Commission on the Efficient Delivery of Services, the Commission on the Efficient Delivery of Educational Services will be of the same size and appointed in the same manner as the former commission. The Efficient Delivery of Educational Services, if established, shall consist of teachers, principals, superintendents, a representative of the Maine Education Association, a representative of the State Board of Education, a representative of the Maine Department of Education, a representative of the Maine School Management Association, and two members of the general public who have demonstrated an interest in public school education.

Sources of Revenues to Fund Committee Recommendations

The following Sales Tax exemptions may be eliminated:

Publications sold on short intervals,
Sales to private schools and colleges,
Sales to regularly organized churches,
Sales to institutions conducting medical research or scientific study in biology,
Camp rentals,
Funeral services,
Sales through coin operated vending machines,
Sales to day-care centers and nursery schools,
Sales to community action agencies, child abuse councils, & child advocacy organizations,
Sales by schools and school-sponsored organizations,
Sales to monasteries and convents,
Sales to state chartered credit unions,
Meals and lodging provided to employees,
Certain aircraft parts,
Personal services,
Amusements and recreational services,
Consumer purchases of memberships in social and miscellaneous services (Charitable donations and labor union dues remain exempt)
Consumer purchases of transportation services, except publicly owned transportation services,
Consumer interstate calls

- Total Revenue from the elimination of selected Sales Tax exemptions in FY 2004: $76,200,000

D. Increase the tax on wine by 15 cents per bottle and the tax on beer by 25 cents per six-pack

- Total Revenues realized in FY 2004: $21,000,000

E. Increase the Meals and Lodging Tax from 7 percent to 8 percent, and an increase in the Lodging tax to 10 percent.

- Total Revenues from increases in the Meals and lodging taxes: $27,000,000+

Total Revenues in FT 2004 **$124,200,000**:

Total Revenues in FT 2005	**$124,200,000**:
Total Revenues – 2004-05 Biennium	**$248,400,000**

Appendix A

Meeting Agendas

Speaker's Advisory Committee on Tax Reform

Suggested Agenda for the August 9, 2002 Meeting

9:00 to 9:40 AM.	Presentation by Laurie Lachance. Maine's Tax Structure: Problems and Remedies.
9:40 to 10:40 AM	Response and Discussion: Panel of Major Interest Groups Maine State Chamber of Commerce Maine Municipal Association Maine Education Association Maine Center for Economic Policy
10:40 to 11:30 AM	Input from interested members of the general public
11:30 to 12:00 Noon	Discussion among Advisory Committee members

Speaker's Advisory Committee on Tax Reform

Suggested Agenda for the August 16, 2002 Meeting

9:00 to 9:40 AM.	Presentation by Laurie Lachance. Maine's Tax Structure: Problems and Remedies.	
9:40 to 11:00 AM	Response and Discussion: Panel of Major Interest Groups	
	Paula Valente	Maine State Chamber of Commerce:Institute for A Strong Maine Economy
	Geoffrey Herman	Maine Municipal Association
	Mark Gray	Maine Education Association
	Kit St. John	Maine Center for Economic Policy
	Subcommittee Members of the Joint Standing Committee on Taxation	
11:00 to 11:30 AM	Input from interested members of the general public	
11:30 to 12:00 Noon	Discussion among Advisory Committee members	

- Proposed future meeting dates
- Proposed agendas for future meetings
- Other

Speakers Advisory Committee on Tax Reform
Agenda
September 6, 2002

9:00 AM to 10:15 AM

I. Study and Discussion of each broad-based tax to include:

- The Property Tax and the local Excise Tax
- The Sales Tax
- The Income Tax
- The Corporate Income Tax
- Other Revenue sources – meals and lodging tax, gas tax

A. **Presentation by Michael Allen, Director of Econometric Research, Maine Revenue Services**

B. **Issues to be addressed with respect to each tax.**

- Different Measures of Tax Burden
- Tax Incidence. Who is paying each tax, and how much of total revenues from each tax is paid by different categories of taxpayers?
- Demographics of Taxpayers. The locations of different groups of taxpayers, taxpayer ages by groups of taxpayers, and other socio-economic data regarding tax burden of each tax.
- Relationships Among the Taxes. How does each tax impact the "system" of taxes and affect other taxes?
- Advantages and Disadvantages of Each Tax
- Remedies

10:15 AM – 10:45 –

II. Questions posed to the Technical Advisory Group – Given the Factual Information on Tax Incidence:

How should Maine's tax structure be reformed?
Who should bear the burden? and
In what proportion should different groups of taxpayers bear the burden?

10:45 AM – 12:00 Noon –

III. Discussion – Members of the Speakers Advisory Committee On Tax Reform.

A. Discussion of Issues
B. **Where do we go from here?**

Agenda

September 20, 2002

Characteristics and Details of a "Good" Tax System

9:00 AM to 10:00 AM

I. What tax system or structure is recommended for Maine? Given that Maine ranks high in respect to tax burden per capita, how can Maine reduce this burden, provided needed services, protect lower income people from regressive tax rates, and remain competitive with the rest of New England and the nation?

   A. Panelists:

      - Professor Josephine LaPlante, University of Southern Maine
      - Professor Mathew Murray, University of Tennessee
      - Mr. Robert Tannenwald, Vice President, Federal Reserve Bank of Boston

II. Break - 10:00 AM to 10:10 AM

III. Questions for the Panel - 10:10 AM to 11:15 AM

IV. Discussion Among Committee Members – 11:15 AM – 12:00 Noon

Speaker's Advisory Committee on Tax Reform

Agenda
October 4, 2002

I. 9:00 A.M. – 10:30 A.M. Committee Discussion

II. 10:30 A.M. – 12:00 Noon Presentations

- Senator Michael Brennan and Representative Glen Cummings – School Funding Formula,
- A Representative from the Commissioner of Education – Regionalization of schools and the school funding formula,
- Philip Trostel, University of Maine – Regionalization of services and intra-municipal cooperation, and
- Representative Ted Koffman – Preliminary Findings and Recommendations of the Committee studying tax policy and land development.

Speaker's Advisory Committee On Tax Reform

October 18, 2002

Agenda

9:00 AM – 9:30 AM Presentations by A Coalition of Tourist Organizations and the Non-profit Association of Maine

9:30 AM to 12 Noon Advisory Committee Deliberations